OUTSOURCING AND FINANCIAL SERVICES

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Under the Rule of Law the law should be prospective, open and clear. This enables people to take decisions in full knowledge of the legal consequences. Where the law is uncertain and over-complicated then planning is more difficult.

An unfortunate feature of VAT law is the problems caused by having two sets of legal rules: domestic law arising from the VATA 1994 and the superior rules contained in the Six Directive.

The rules contained in the Sixth Directive ultimately trump and are increasingly relied upon in litigation at all levels. Conversely, good planning must start with the domestic law because Customs and Excise are not going to start arguing that UK domestic law is inconsistent with the Sixth Directive. The safest planning is to fall squarely within the relevant provisions of both domestic and European law.

Usually, domestic and European law is the same but sometimes a potential conflict may be identified at the planning stage. Just

occasionally the commercial requirements may mean that the best course is to be aggressive and rely on the Sixth Directive at the planning stage on the basis that domestic law is inconsistent.

The area of outsourcing within the financial services sector is one where these issues arise in practice. As business develops, the law slowly catches up. Accordingly, it is no surprise that outsourcing has spawned a number of recent and ongoing cases. The purpose of this article is not to review those cases but to draw attention to a few points relevant to planning in this area.

Firstly, a supply of services comprising the management of credit made by someone other than the person granting the credit is entirely excluded from the VAT exemption by Note 2A of Group 5 Schedule 9 VATA 1994. The concept of management of credit is thereby elevated into an overriding exclusive concept and is defined in Note 2B.

This seems to be inconsistent with the Sixth Directive. Under Article 13B(1) the management of credit by the person granting it is specifically exempted. But there is nothing to say that services provided by others that might fall within the definition of management of credit are always taxable.

For example, transactions concerning current accounts including negotiation, payments and transfers are specifically exempted. There is no requirement that the services must be supplied by the person granting the credit. Accordingly, the UK's implementation of the Sixth Directive is either faulty because it is inconsistent with European law or defective because it employs slightly different concepts to achieve the same result. Surely Parliament should follow the words of the Sixth Directive as closely as possible when trying to implement it?

Again, suppose an intermediary makes decisions about whether to issue a credit card. Under strict UK law this would not be exempt because taking decisions relating to an application for a grant of credit is specifically excluded by Note (2B)(d). In contrast, Article 13B(d)(1) expressly exempts the granting and negotiation of credit without restriction as to who is doing the negotiation. As opposed to the management of credit, which is restricted to the person who granted it.

Meanwhile the cases that are being appealed through the courts are slowly clarifying the law. Following the Court of Appeal's decision in C & E v FDR Ltd [2000] STC 672 that a company supplying credit card services to banks made exempt supplies, Customs accepted in Business Brief 10/2001 that the borderline between exempt and taxable supplies

needed to be redrawn is UK law. The consultation is ongoing and Customs still maintain both that the management of credit should only be exempted when supplied by the lender and that it should be widely defined.

Meanwhile, the cases have tended to favour a broader reading of what is exempt. In Sparekassernes Dataeenter v Skalteministeriet [1997] STC 932, the ECJ declined to read any condition into Article 13B(d)(3) that the transactions be effected by a certain type of institution or in a certain way. In Lloyds TSB [1998] STC 528 and again recently in Electronic Data Systems [ref] certain supplies made by intermediaries were held exempt. The wind is clearly blowing in favour of the taxpayer. In the long term this is good news for taxpayers. However, in the short term planning is made needlessly difficult because the law is uncertain and an excessive number of principles are found in the case law rather than the statutes.

Ultimately the Sixth Directive will prevail, as it always does. Nevertheless, the whole process would be much easier if it was transposed into domestic law more directly. On a broader note, these inconsistencies in VAT distort competition and ultimately waste resources.

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